"Declining Exports in Italy and France: Cause for Concern?"

Lionel Fontagné and Gianmarco Ottaviano

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During the current global cyclical upswing the EU has seen marked divergences in performance between sectors and countries. Amongst the most striking has been the relatively poor recent record of exports by France and Italy, especially when compared with Germany.

Lionel Fontagné, professor of economics at University of Paris and member of Conseil d'Analyse Economique and a Director of CEPII, and **Gianmarco Ottaviano**, a Professor of Economics at University of Bologna, concluded that micro-economic factors are key determinants in explaining these differences.

Both agreed that export performance *per se* is not, and should not be, a target of economic policy. A relative weakening of export performance in a sector such as manufacturing *vis a vis* a country at a similar stage of economic development, may, however, provide evidence which points towards important underlying economic weaknesses and provide guidance to policymakers in selecting priorities.

Jean Pisani-Ferry, presented a slide which demonstrated a significant deterioration in the export performance of both France and Italy, not only relative to Germany but also compared with the European Union as a whole. What, he asked, explains this relative weakness? One common explanation has been deteriorating export price competitiveness. But while this could, plausibly, be a factor in the case of Italy, it is not obvious that this has contributed to the relative weakness of French exports.

Professor Fontagné noted that over the past years the French trade deficit has risen sharply hitting Euro 24.5 billion during the past twelve months, a sharp contrast with the buoyancy of the German exports and its positive trade balance. From 1994 until 2000, France and German export volumes had been growing at around the same rate and in line with world trade. Since 2000, however, France's export performance has declined relative to Germany's and relative to world trade. Interestingly import growth in both countries has remained the same. So it is to export performance that you have to look for an explanation of the relative deterioration of the trade balance. (For Italy the relative deterioration in export volumes goes back to 1994.)

Breaking the data down in more detail, it appears Germany has been more successful at exporting to emerging market economies, where it has been gaining market share, while

France and Italy have not. The growth of German exports to China and Russia, for example, has outstripped French and Italian exports. But what are the explanations for this?

On the macro economic side, there is some evidence to suggest that Italy, but not France, has suffered more from a relative appreciation of its real exchange rate owing to a rise in unit costs. But this does not explain the difference between France and Germany, even though, just in the past two years, the long standing French cost advantage *vis a vis* Germany has indeed begun to erode.

Professor Fontagné concluded by looking at a number of microeconomic factors which could be influencing French export performance. Industrial structure is not the problem. France and Germany's manufactured exports have similar shares of "top range" products (products which command premium prices). He also suggested that there are no significant differences in the quality of products offered. However, what does seem to be the case is that French exports are concentrated in fewer markets than German exports and that French firms do not respond as efficiently to price signals as their German rivals.

Turning to Italy, **Professor Ottaviano** said that Italy's poor export performance suggested it had both a cost problem, and, more significantly for the economy as a whole, a productivity problem. This shows up in terms of both relative declines in GDP per capita and productivity growth to which GDP per capita is correlated.

One of Italy's problems seems to be an increasing specialisation in the exporting of traditional products by small firms in mature industrial sectors in which productivity growth is sluggish and which are vulnerable to competition from emerging market countries, such as China, as trade is liberalised. Leather and footwear are good examples.

Italy had, before the launch of the euro, maintained competitiveness through currency devaluations which allowed unproductive firms to get into export markets. But as it lost competitiveness in highly contestable markets, its weaker exporters were easily forced out of export markets.

Why is this the case? Is it because there is not enough competition in Italy's domestic market and therefore not enough pressure on firms to improve their productivity? Is it because of low levels of investment in research and development? OECD data, Professor Ottaviano pointed out, is a laggard in terms of private sector investment in R&D. There is also inadequate investment in human capital.

Jean-Pisani Ferry noted a common theme of the two presentations was that it is to the level of the individual firm, the microeconomic level, which we should look in order to understand better the forces at work behind deteriorating export performance in the two countries.

Professor André Sapir, of Bruegel, intervened to highlight one of the main conclusion of **Professor Fontagné's** presentation, namely that, in the case of France, for whatever

reason, there were impediments which did not permit French exporters to take advantage of the recent upswing in world trade. But why, in the period of faster world trade growth from 1994-2000, did French exporters not have a problem, while in the slower period of world trade growth from 2000-2005, they did?

Professor Fontagné wondered whether one problem is that French exporters tend to be larger firms, "national champions," and that they are not able to respond to upsurges in demand in new markets in the way that smaller more flexible firms do.

Nicholas Véron, of Bruegel, wondered whether it is possible to break down the data so that the performance of larger and smaller firms or firms which are just entering into new emerging country export markets, can be separated out? Secondly, were there particular management, cultural and technological challenges facing French exporters? Perhaps they do not know how to adapt to the challenge of exporting to these new markets or to use technology to help them build global supply chains in the way US firms have.

A participant added that perhaps the real challenge was to explain the success of Germany's exporters.

Professor Fontagné responded that he does believe cultural factors are at work. Germany benefits from having a large population of SME's exporting to fast growing markets like China, whereas, in the case of France a small number of companies represent 70-80% of French exports to China. He added however that demonstrating this difference is not possible because of the lack of data.

Juan Delgado of Bruegel wondered what the policy recommendations which spring out of the analysis are.

Professor Ottaviano responded that, at least in the case of Italy, it would seem that product market rigidities, perhaps related to the local monopoly power of firms who are not put under enough competitive pressure to improve their productivity, is a key issue which needs to be addressed.

A participant asked whether the problem is that the performance of the French and Italian export sectors is a constraint on the trade balance or is it, in the case of Italy for example, the evidence from its poor trade performance, that the country is not making the necessary productivity adjustment ?

Professor Ottaviano responded that the central issue is the lack of growth of Italian productivity. The foreign trade performance is an indicator of the underlying, economy wide, productivity problem. It indicates that Italy is not adjusting to external shocks. "Your export capacity reveals what is happening to your economy," he concluded.